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C O N F I D E N T I A L SECTION 01 OF 03 TAIPEI 004187

SIPDIS

DEPT PASS TO AIT/W AND USTR
DEPT FOR EAP/TC, EAP/EP, EB/IFD/OIA, AND EB/IFD/OMA
TREASURY FOR OASIA MOGHTADER AND OCC AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE BOARD OF GOVERNORS,
SAN FRANCISCO FRB AND NEW YORK FRB

E.O. 12958: DECL: 10/14/2020

TAGS: [EFIN](#) [PREL](#) [PINR](#) [TW](#)

SUBJECT: TAIWAN FINANCIAL REFORM BECOMES POLITICAL CONTEST

REF: A. TAIPEI 2131

[1](#)B. TAIPEI 3288

[1](#)C. TAIPEI 3880

Classified By: AIT DIRECTOR DOUGLAS PAAL, REASON 1.5 B/D

[1](#)1. (C) Summary: Taiwan's second stage financial reforms have become the subject of a heated political contest and media debate. Opposition parties have been able to capitalize on misgivings raised by labor union opposition to privatization and an opaque bidding process as an effective way to cast suspicion on the Chen Administration's motives and integrity. Within the past two weeks, President Chen and other senior officials have repeatedly tried to defend the reforms, but public mistrust of government institutions and officials is growing in the face of almost daily media reports of official corruption and misuse of power. End summary.

The Second Stage of Financial Reform

[1](#)2. (C) The announced goals of the second stage of Taiwan's financial reform are to reduce the number of state-owned banks from 12 to 6 by the end of 2005, to reduce the number of financial holding companies (FHCs) from 14 to 7 by the end of 2006 and to sell controlling interest in a state-owned bank to a foreign bank by the end of 2005. When President Chen announced the second stage reforms on October 20, 2004, it was with pride in the success of the first stage of reform in lowering non-performing loan (NPL) levels among Taiwan banks (from a high of 11.7% in March 2002 to below 2% at present), and confidence in the unassailable virtue of the goals. After all, both international and Taiwan think tanks had for years been calling for privatization of state-owned banks, reduction of the number of banks, and introduction of foreign managerial expertise. Administration officials hoped that after reducing the number of banks and FHCs, the remaining ones would be more profitable and have sufficient scale to compete with large foreign banks. Financial officials have consistently, confidently, and convincingly explained to AIT that achieving these goals is necessary if Taiwan is to play any significant role in regional finance.

Sale of CCB

[1](#)3. (C) In mid-March 2005, in what Taiwan officials told AIT would be a "landmark case that would set the tone for future bank sales," two foreign bank consortia bid on a deal for controlling interest in the state-owned Changhwa Commercial Bank (CCB). As reported ref B, the sale fell through when the two foreign consortia made offers substantially below the prevailing market price of CCB equity shares. Post-bid negotiations between the Ministry of Finance and the foreign consortia that lasted until May were denounced by the bank labor union and opposition legislators as an un-patriotic discounted sale of public property to foreigners. The failure to sell CCB not only was a serious blow to the reform plan, but also fueled public doubts about the motivations of government officials. The sale of controlling interest in CCB was finally accomplished in late July when Taiwan's Taishin Financial Holding Company agreed to pay twice what the foreign consortia had offered. Initially, this was widely interpreted as a big and surprising success for the reform program.

[1](#)4. (C) However, as the details of the deal offered to Taishin were analyzed, it became apparent that Taishin had acquired control over Changhwa with virtually no risk to its own capital. Media and opposition politicians expressed outrage at the selling of public assets to one of Taiwan's controlling financial groups, further enriching one of its richest pro-DPP families.

Allegations of Corruption

15. (C) One of the most vocal critics of the sale has been Peoples' First Party Legislator Dr. Christina Liu. During a lunch address to AIT Junior Officers on October 12, Dr. Liu explained some of her criticisms of the Chen Administration's approach to financial reform. She expressed the view that the second stage financial reform goals of cutting the number of banks and FHCs in half were both arbitrary and pointless. She told AIT that "Even if all Taiwan banks were merged into one that wouldn't automatically increase the competitiveness or profitability of the banks." "Big doesn't necessarily mean good," she continued, "Look at Japan, which has three of the ten largest banks in the world, but which still are poorly run." However, when pressed for her recommendations, she said the problem was not the goals, but the non-transparent (read corrupt) way they were being implemented. She also said Taiwan banks had no chance of becoming competitive regionally as long as they were prevented from doing business in China.

16. (C) Dr. Liu strongly implied that the Chen Administration was pushing bank privatization for reasons of corruption and cronyism. She noted that the number of state-owned banks was being reduced from 12 to 6 and speculated that the number 6 was probably chosen in order to give each of Taiwan's three wealthiest families control of two of the privatized banks. She suggested that the ruling Democratic Progressive Party doubts its ability to stay in power after the 2008 elections and wants to take full advantage of its remaining time in control to profit financially. However, she added, if the KMT had won the 2004 presidential election, it would probably have engaged in corruption as well.

17. (C) After her talk to the AIT Junior Officers, Dr. Liu privately confided to an Economic Officer that she believed Taiwan's First Lady, Wu Shu-chen, was personally involved in fixing the sales of state-owned assets for her own financial gain.

Worthy Notions Employed for Unworthy Ends

18. (C) In light of the years of USG and Amcham Taipei urging privatization and financial reform as the path to continued prosperity, the notion that Taiwan's privatization of state-owned assets is motivated primarily to profit the President's cronies is jarring. Yet, Dr. Liu, an extremely savvy economist who trained at the University of Chicago, has repeatedly alleged this to AIT and to the Taiwan media. Not surprisingly, large numbers of Taiwan people without training in economics find the conspiracy theory more plausible than the economic one. Other well-informed local contacts have echoed these views that the privatization of state-owned banks and other enterprises is being done in order to benefit a few wealthy, well-connected families; that the Chen Administration is trying to get the maximum financial benefit of its remaining time in power; and that corruption is the behavioral norm of government officials.

Administration Challenged to a Public Debate

19. (C) Opposition to the second stage of reforms has become a staple in media reporting. On October 7, the legislative caucus of the opposition KMT publicly urged the government to suspend the plan, saying that the government first needs to clear public suspicions that the plan is favoring specific financial groups in the name of privatization. After heated debate within the Legislative Yuan (LY) Financial Committee, the LY passed a non-binding resolution opposing the privatization of state-owned banks. The KMT legislative caucus on October 11 challenged the Presidential Economic Advisory Group to publicly debate the reform plan, claiming that it will lead to Taiwan's financial industry being further dominated by a few wealthy families.

President on the Defensive

10. (C) The Chen Administration has been forced to defend its reform plans. Among the points Taiwan President Chen Shui-bian made in his October 10 National Day address was a pledge to complete second-phase financial reforms as a priority task. In recent days, this same pledge has been made by the Vice President, the Premier, the Vice Premier, the Minister of Finance, the Chairman of the Financial Supervisory Commission (FSC) and other high-ranking executive branch officials on an almost daily basis. FSC Chairman Kong Jaw-sheng has insisted to the media that all of the second stage goals will be accomplished as scheduled and that "several" possible deals for foreign acquisition of a state-owned bank are nearing the final stages of negotiation. Kong is currently leading a forum in New York October 13-14 to brief prospective foreign investors on Taiwan's second stage financial reforms and its general investment environment and incentives for foreign investors.

11. (C) In a graphic illustration of the Administration's defensive posture on this issue, local newspapers on October 7 pictured the Minister of Finance and the FSC Chairman sheepishly admitting during questioning by the LY Finance Committee that they had no idea how the specific numerical goals of the second stage of financial reform had been developed.

Where There's Smoke

12. (C) Dr. Lee Bin-Zheng (strictly protect), Professor and Chairperson of National Sun Yat-sen University Department of Political Economy recently told AIT/K that as a member of the Executive Yuan Consulting Committee for the Privatization of State-Run Enterprises, he was astonished to discover that participating bidders for the planned projects have already been selected and "outsiders" screened out; and although there is a complex bidding process, the outcome is pre-determined. Dr. Lee noted that he is no longer a strong supporter of the DPP as he has lost his enthusiasm and confidence in the DPP.

Comment

13. (C) Recent corruption and mismanagement scandals have amplified the disarray of the Chen Administration to the point where its ability to implement its economic policies is increasingly in doubt. Blood is in the water and touted financial reforms are being attacked as instruments of corruption.

14. (C) For months, on an almost daily basis Taiwan's media have carried reports of organized crime activities and government corruption. The sacking of two senior presidential advisors on October 5 for alleged corruption brought the problem into the President's office and highlighted the problems of cronyism and corruption within the ruling Party.

15. (C) While it is difficult to determine how much of the reporting on the seamy-side of Taiwan society is a creation of its free-wheeling media, how much is political mud-slinging, and how much is a true reflection of corrupt government institutions, perceptions may be as important as facts in feeding a growing public mistrust of politicians, government officials, and institutions.

16. (C) Chen's ability to implement the second stage financial reforms will be a litmus test of his administration's ability to rebuild public trust and govern.
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